



**JOHN CHIANG**  
**California State Controller**  
Division of Accounting and Reporting

February 5, 2014

To: County Official

Re: Maintenance vs. Capital Improvement

Dear County Official:

The State Controller's Office has recently received guidance from the federal Department of Health and Human Services (DHHS), Division of Cost Allocation, regarding the determination of whether major building repairs and replacements should be classified as routine repairs and maintenance or as capital improvements in the Countywide Cost Allocation Plans (CCAPs). The treatment of costs for a Heating, Ventilation and Air Conditioning (HVAC) system is used as an example of how major building components should be accounted.

If your County is considering or in the process of any major building repairs or replacements to be included in the CCAP, please review this letter to ensure compliance with this recent guidance. The replacement of major building components (such as an HVAC system) must be treated as a capital improvement, recovering costs over the useful life via use allowance or depreciation expense in the CCAP. When determining the treatment of any major building repairs or replacements, consideration must be given to the requirement that costs charged to Federal grants are in accordance with relative benefits received. It is equitable to allocate the costs over the useful life of the asset, because all of the Federal, State and county programs that are performed in that building during the many years the HVAC system is in use, will receive the benefit of the replacement.

The DHHS policy letter can be found on the State Controller's Office website at [www.sco.ca.gov/ard\\_county\\_cost\\_allocation.html](http://www.sco.ca.gov/ard_county_cost_allocation.html) under "Policy Statements". If you have any questions regarding this policy, please call Phillip Pangilinan of the County Cost Plans unit at (916) 327-2284.

Sincerely,

A handwritten signature in cursive script, reading "Anita Dagan", is positioned above the printed name.

ANITA DAGAN, Manager  
County Policy Section

Enclosures



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Program Support Center  
Financial Management Service  
Division of Cost Allocation

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Ms. Anita Dagan, Manager  
County Policy Section  
California State Controller's Office  
P.O. Box 942850  
Sacramento, CA 94250

NOV 01 2013

Subject: Maintenance vs. Capital Improvement

Dear Ms. Dagan:

This is in response to your letter dated August 5, 2013, in which your office requested guidance regarding the determination of whether major building repairs and replacements should be classified as routine repairs and maintenance (expensed in the year incurred), or as capital improvements (capitalized and recovered through either depreciation or use allowance) in Countywide Cost Allocation Plans (CCAPs). Specifically, there was a concern as to whether the replacement of a Heating, Ventilation and Air Conditioning (HVAC) system should be treated as a maintenance cost since it does not materially increase the value or useful life of the building.

Generally, we require replacements of major building components to be capitalized and recovered via either use allowance or depreciation expense. Major building components such as HVAC systems are in use for many years, and the costs should be amortized over the useful life. It is not equitable to expense a major replacement in one fiscal year and allocate the costs only to the Federal, State and county programs that the county happens to be performing in the year of expenditure. It is more equitable to allocate the costs over the useful life of the asset, because all of the Federal, State and county programs that are performed in that building during the many years the HVAC system is in use will receive the benefit of the replacement. In other words, the CCAPs must comply with 2 CFR Part 225 – Cost Principles for State, Local and Indian Tribal Governments (OMB A-87), Appendix A, Paragraphs C, 1.b. and 3.a., which requires costs to be charged to Federal programs in accordance with relative benefits received. Therefore, we require the replacement of major building components (such as an HVAC system) to be treated as a capital improvement, recovering costs over the useful life via use allowance or depreciation expense.

If you have any questions about this letter, please contact Naomi Tamashiro, Branch Chief, at (415) 437-7822.

Sincerely,

Arif Karim, Director  
Division of Cost Allocation